MILLETT J: It was common ground that an administrator owes a duty to a company over which he is appointed to take reasonable steps to obtain a proper price for its assets. That is an obligation which the law imposes on anyone with a power, whether contractual or statutory, to sell property which does not belong to him. A mortgagee is bound to have regard to the interests of the mortgagor, but he is entitled to give priority to his own interests, and may insist on an immediate sale whether or not that is calculated to realise the best price; he must 'take reasonable care to obtain the true value of the property at the moment he chooses to sell it': see *Cuckmere Brick Co Ltd v Mutual Finance Ltd*.[19] An administrator, by contrast, like a liquidator, has no interest of his own to which he may give priority, and must take reasonable care in choosing the time at which to sell the property. His duty is 'to take reasonable care to obtain the best price that the circumstances permit': see *Standard Chartered Bank Ltd v Walker*.[20]

(p. 775) It is to be observed that it is not an absolute duty to obtain the best price that circumstances permit, but only to take reasonable care to do so; and in my judgment that means the best price that circumstances *as he reasonably perceives them to be* permit. He is not to be made liable because his perception is wrong, unless it is unreasonable.

An administrator must be a professional insolvency practitioner. A complaint that he has failed to take reasonable care in the sale of the company's assets is, therefore, a complaint of professional negligence and in my judgment the established principles applicable to cases of professional negligence are equally applicable in such a case. It follows that the administrator is to be judged, not by the standards of the most meticulous and conscientious member of his profession, but by those of an ordinary, skilled practitioner. In order to succeed the claimant must establish that the administrator has made an error which a reasonably skilled and careful insolvency practitioner would not have made …

No duty owed by the administrator to creditors.

[16.03] Kyrris v Oldham [2004] BCC 111 (Court of Appeal)

The facts are immaterial.

JONATHAN PARKER LJ:

141 In my judgment it matters not whether one adopts the approach of the House of Lords in *Caparo Industries plc v Dickman* **[8.04]**, or the 'assumption of responsibility' approach which it adopted in *Henderson v Merrett Syndicates*:[21] on either approach the result is the same, namely that, absent some special relationship, an administrator appointed under the 1986 Act owes no general common law duty of care to unsecured creditors in relation to his conduct of the administration.

142 In paras 31–34 of his judgment in *Peskin v Anderson*,[22] Mummery LJ said this:

'31. … [Counsel for the directors] accepted that the fiduciary duties owed by the directors to the company do not necessarily preclude, in special circumstances, the coexistence of additional duties owed by the directors to the shareholders. In such cases individual shareholders may bring a direct action, as distinct from a derivative action, against the directors for breach of fiduciary duty.

32. A duality of duties may exist. In *Stein v Blake* [1998] BCC 316 at pp 318 and 320 Millett LJ recognised that there may be special circumstances in which a fiduciary duty is owed by a director to a shareholder personally and in which breach of such a duty has caused loss to him directly (eg by being induced by a director to part with his shares in the company at an undervalue), as distinct from loss sustained by him by a diminution in the value of his shares (eg by reason of the misappropriation by a director of the company's assets), for which he (as distinct from the company) would not have a cause of action against the director personally.

33. The fiduciary duties owed to the company arise from the legal relationship between the directors and the company directed and controlled by them. The fiduciary duties owed to the shareholders do not arise from that legal relationship. They are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case. Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities, which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders.

(p. 776) 34. These duties may arise in special circumstances which replicate the salient features of well established categories of fiduciary relationships. Fiduciary relationships, such as agency, involve duties of trust, confidence and loyalty. Those duties are, in general, attracted by and attached to a person who undertakes, or who, depending on all the circumstances, is treated as having assumed, responsibility to act on behalf of, or for the benefit of, another person. That other person may have entrusted or, depending on all the circumstances, may be treated as having entrusted, the care of his property, affairs, transactions or interests to him. There are, for example, instances of the directors of a company making direct approaches to, and dealing with, the shareholders in relation to a specific transaction and holding themselves out as agents for them in connection with the acquisition or disposal of shares; or making material representations to them; or failing to make material disclosure to them of insider information in the context of negotiations for a take-over of the company's business; or supplying to them specific information and advice on which they have relied. These events are capable of constituting special circumstances and of generating fiduciary obligations, especially in those cases in which the directors, for their own benefit, seek to use their position and special inside knowledge acquired by them to take improper or unfair advantage of the shareholders.'

143 It has not been suggested (nor could it be, in my judgment) that there is any relevant distinction for present purposes between a fiduciary duty and a common law duty of care. Further, I accept Miss Hilliard's submission that the position of an administrator appointed under the 1986 Act vis-à-vis creditors is directly analogous to that of a director vis-à-vis shareholders.

144 Section 8(2) of the 1986 Act defines an administration order as: '… an order directing that, during the period for which the order is in force, the affairs, business and property of the company shall be managed by a person ("the administrator") appointed for the purpose by the court.'

145 Section 14(1) of the 1986 Act confers on an administrator a number of specific powers of management set out in Sch 1, including (in para 14) a power to carry on the business of the company, together with a general power: '… to do all such things as may be necessary for the management of the affairs, business and property of the company'.

146 Given the nature and scope of an administrator's powers and duties, I can for my part see no basis for concluding that an administrator owes a duty of care to creditors in circumstances where a director would not owe such a duty to shareholders. In each case the relevant duties are, absent special circumstances, owed exclusively to the company.

147 It is also material, in my judgment, to consider the nature of the remedy provided by s 212 of the 1986 Act. Section 212(3) provides that on an application under the section the court may compel an administrator (among others):

'**(a)** to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or
(b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just.'

148 To my mind, this is a further indication that, absent some special relationship of the kind described by Mummery LJ in *Peskin v Anderson*, an administrator owes no general duty to creditors.

➢ Notes

1. This case has been followed in *Hague v Nam Tai Electronics* [2008] UKPC 13, [2008] BCC 295, PC (a case concerning a liquidator rather than an administrator).

2. In *Re Capitol Films Ltd (In Administration)* [2010] EWHC 3223 (Ch), after finding that the assets of the film company were only sufficient to meet the claims of secured creditors (or part thereof), Mr Richard Snowden QC held that the administration was therefore 'being **(p. 777)** conducted to make a payment to the secured creditors, and that it was, in essence, a substitute for each of the holders of fixed security conducting their own sales of the charged assets' [87]. Accordingly, given the administrators' failure to consider the interests of the secured creditors, and their failure to investigate the validity of a purported assignment of valuable rights in certain films executed prior to the company's insolvency, an application brought under IA 1986 Sch B1, para 71 (to dispose of the film rights in question as if they were not subject to any fixed security to yield an overall greater return) had no real prospect of success. As such, it was neither reasonable nor rational for the administrators to have made this application; it was 'wrong to commence and pursue the application under paragraph 71 in the manner that they did' [94]. It followed that the administrators were ordered to pay the costs of the secured creditors who appeared to oppose the application. Indeed, their acts were held to be so 'out of the norm' and 'unreasonable to a sufficiently high level' as to justify an indemnity costs order [97].[23]

3. Given that the administrator is an agent of the company as principal, the court in a recent summary application accepted that an administrator acting in good faith in the course of his duties as administrator will not be held liable for procuring the breach of a contract between the company and a third party: *Lictor Anstalt v Mir Steel UK Ltd* [2011] EWHC 3310 (Ch) (affd on other grounds, [2012] EWCA Civ 1397). This 'defence of justification' finds its roots in *Said v Butt* [1920] 3 KB 497, which referred to a director's role in causing his company to act in breach of contract.

Effect of appointment on directors

The appointment of an administrator leaves the directors with very limited authority (though they retain their statutory responsibilities). IA 1986 Sch B1, para 64 provides that any power of the company or its officers that could be exercised in such a way as to interfere with the exercise by the administrator of his powers is not exercisable except with the consent of the administrator.

Termination of administration

Administration ends automatically after one year, unless the term is extended by consent of the creditors or order of the court (Sch B1, para 76). Otherwise it can be terminated by the administrator (unilaterally or under directions from a creditors' meeting), or by a creditor on application to the court (Sch B1, paras 79–83).

Priority of expenses of administration

The expenses of an administration have priority over a debt secured by a floating charge (Sch B1, para 99). But debts or liabilities arising out of contracts entered into by the administrator (including contracts of employment adopted by the administrator so far as they relate to post-adoption work) have priority over the administrator's own remuneration and expenses ('super-priority') (Sch B1, para 99(3) and (4)).[24]

(p. 778) For a detailed consideration of the distinction between provable debts and expenses, see *Re Nortel GmbH; Re Nortel Networks UK Pension Trust Ltd; Re Lehman Brothers International (Europe) (In Administration)* [2011] EWCA Civ 1124, CA. The case arose out of the insolvency proceedings of Nortel and

Lehman Brothers. The Court of Appeal (Lloyd LJ giving the judgment of the court, with Laws and Rimer LJJ concurring) affirmed the lower court's ruling that the company's liability arising from a financial support direction or a contribution notice pursuant to the Pensions Act 2004 constituted a 'necessary disbursement' of the liquidator or administrator.[25]

In similar vein, *Re Luminar Lava Ignite Ltd* [2012] EWHC 951 (Ch), illustrates the position of sums falling due as rent in different circumstances. Finally, in *Re Bickland Ltd*[2012] EWHC 706 (Ch), the court was willing to treat the costs of a director's dismissed application to appoint administrators (after a co-director had appointed administrators) 'as if' they were administration expenses, despite these falling out of the defined list under IR 1986 r 2.67.

Receivership and administrative receivership

Receivership generally

Any secured creditor may enforce his security by the appointment of a receiver. So, for example, if a company has given a creditor a fixed charge over its book-debts, the appointment of a receiver will enable the debts to be collected and applied in satisfaction of the company's obligation. This may always be done by order of the court; but in practice the instrument by which the security is created will invariably confer on the holder of the security a power to appoint a receiver without recourse to the court. Receiverships (and administrative receiverships, to the extent that they still exist) are thus insolvency procedures operating largely without the involvement of the courts.[26]

Until the reforming insolvency legislation of 1985–86, the subject of receivership was largely a matter for the common law. There are now a number of provisions in IA 1986 Pt III which apply generally to receiverships: for example, there is a prohibition on the appointment of a body corporate or an undischarged bankrupt (ss 30–31); there must be notification on the company's stationery of the appointment of a receiver (s 39); and it is declared that normally a receiver is personally liable on any contracts he makes, but subject to a right of indemnity out of the assets under his control (ss 37(1) and 44).

A receiver appointed by the court is an officer of the court and accountable to it, and is not subject to direction or to dictation by the creditor in whose interests he has been appointed. A receiver appointed independently may in theory be the agent either of the company or of the creditor who appointed him: in practice, he is always expressly made the former (and this is now a statutory rule in the case of an *administrative receiver* (see the following section)). This agency (whether contractual or statutory) enables the receiver to enter into contracts in the company's name, employ staff and so on, but it ceases if the company goes into liquidation. From then on he continues to be competent to realise the company's assets for the purpose of discharging the secured debt, and to take any necessary steps to protect and preserve those assets, but he can no longer incur credit in the company's name or cause it to incur executory **(p. 779)** obligations. Note, however, the 'unusual' features in this agency relationship as enunciated in a recent case considering the duties owed by a firm of solicitors retained by the receivers of a company in receivership: *Edenwest Ltd v CMS Cameron McKenna (A Firm)* [2012] EWHC 1258 (Ch).

The primary duty of a receiver is to get in and, as necessary, realise sufficient of the company's assets and undertaking to satisfy the outstanding debt of the creditor on whose behalf he has been appointed. He does not owe duties of a fiduciary nature (in the fullest sense) to the company or the other creditors, although he may be liable to them if he uses his powers for an improper purpose (*Downsview Nominees Ltd v First City Corpn Ltd* **[16.05]**). He is under an obligation to keep and produce to the company proper accounts (*Smiths Ltd v Middleton* [1979] 3 All ER 842). In these respects his position may be contrasted with that of an administrator or a liquidator. A receiver's duties are owed first and foremost to the security holder who has appointed him, and the interests of the company, its trade creditors and any other person concerned can legitimately be subordinated to those of the security holder. An administrator or liquidator, however, is required to deal with the company's assets for the benefit of *all* the interested parties.

It is very common for an appointment to be made, not simply of a receiver, but of a *receiver and manager*—a twin

office under which the appointee is empowered to manage the business and not just get in and sell off its assets. This is done in the hope either that the company may be able to trade its way back into profitability or, at the very least, that its business can be sold as a going concern rather than on a break-up basis and in that way fetch more. Of course, a power to manage 'the business' of a company can be given to a receiver only if the charge is over the whole of the company's undertaking—which means that it must be a floating charge.

The appointment of a receiver and manager puts an end to the directors' powers to manage the business, though they will revert once he has discharged his functions, so long as the business or part of it has survived. But the directors do retain their *office*, and their other powers and functions: in *Newhart Developments v Co-operative Commercial Bank* [1978] QB 814, it was held that they had power to issue a writ claiming damages for breach of contract against the very creditor who had appointed the receiver.[27] Likewise, the directors have the power to take proceedings to challenge the validity of the receiver's appointment, to oppose a petition to wind up the company or to cause the company to sue the receiver for breach of duty.

A company that is in receivership may be put into liquidation. The liquidator has then, in principle, to allow the receiver to continue to act until the claims of his debenture holders or chargee are met out of the security. Conversely, a receiver may be appointed after a company has gone into liquidation; and, as we have seen, the fact of liquidation is itself effective to crystallise a floating charge.

Where a receiver is appointed to enforce a floating charge, the claims of certain preferential creditors (eg employees for certain claims) must be paid ahead of the debenture holder: IA 1986 s 40. In addition, a certain proportion must be set aside for the unsecured creditors: IA 1986 s 176A.

Administrative receivership

The main innovation made by the insolvency legislation of 1985–86 was the introduction of a separate category of receiver, the *administrative receiver*. Although this was a major **(p. 780)** innovation at the time, the reforms of EA 2002 signal the end for most administrative receiver-ships (see the following section).

An administrative receiver is defined by IA 1986 s 29(2). Essentially, administrative receivers are receivers and managers of the whole, or substantially the whole, of the property of a company appointed by or on behalf of the holders of a debenture of the company secured by a floating charge.[28] IA 1986 stipulates that administrative receivers must be qualified insolvency practitioners (ss 45(2) and 388–389), and confers on them a number of statutory powers (ss 42–43 and Sch 1). It also declares that they are deemed to be the company's agent, unless the company is in liquidation (s 44); this converts to a rule of law what was previously the standard practice under the usual terms of floating charge debentures before the Act.[29] The Act requires the directors to provide administrative receivers with information about the company by submitting to them a statement of affairs (s 47), but in turn requires the administrative receivers to keep the company's unsecured creditors informed about the progress of the receivership (s 48). This report must also be sent to secured creditors and to the registrar at Companies House.

Enterprise Act 2002 reforms—limited scope for administrative receiverships

After the reforms of EA 2002, it is not now possible to appoint an administrative receiver under a floating charge created on or after 15 September 2003 (IA 1986 s 72A; Insolvency Act 1986, Section 72A (Appointed Date) Order 2003 (SI 2003/2095)), except in special cases specified in IA 1986 ss 72B–72H.[30] Instead, the chargee has the right to appoint an administrator (IA 1986 Sch B1, para 14). Recall that an administrator is an officer of the court (Sch B1, para 5) who performs his functions in the interests of the company's creditors as a whole (Sch B1, para 3(2)).

Chargees with floating charges created before 15 September 2003 retain the right to appoint an administrative receiver, but also have the option to appoint an administrator. A chargee whose floating charge does not cover the whole or substantially the whole of the company's assets can still appoint a receiver, who will by definition not be an administrative receiver, but cannot appoint an administrator.[31] An administrator, administrative receiver or receiver cannot be appointed unless the charge is enforceable.

These EA 2002 reforms, largely doing away with administrative receivership, were intended to favour the rescue culture. An administrative receiver is entitled to put the secured creditor's interests first, and a suspicion prevailed that the interests of unsecured creditors and the company itself were not always best served; by contrast, an administrator must manage the company's affairs for the benefit of everyone concerned.

Powers of management—company contracts

An administrative receiver may cause the company to repudiate any contracts entered into before he was appointed. The only remedy the injured party will have is a claim against the company for breach of contract. If the claim sounds in damages only, then the company is unlikely to be able to pay once the claims of the secured creditor are met (*Airlines Airspares Ltd v Handley Page Ltd* [1970] Ch 193). If, on the other hand, the contract is one for which **(p. 781)** the court will award specific performance or an injunction, then the injured party is protected (*Freevale Ltd v Metrostores (Holdings) Ltd* [1984] Ch 199).

An administrative receiver is personally liable on any new contract entered into in the performance of his functions, except insofar as the contract otherwise provides (IA 1986 s 44(1)(b)). So far as personal liability is assumed, the administrative receiver is entitled to an indemnity out of the assets of the company (s 44(1)(c)). In practice, he will also have an indemnity from the chargee. In the majority of cases, however, his aim will be expressly or impliedly to exclude all personal liability.

Employment contracts are a special class. Since the administrative receiver is the company's agent, the appointment does not automatically terminate these contracts. If the administrative receiver finds that the employees cannot be retained, he may dismiss them, and this will almost certainly not be unfair dismissal. On the other hand, if he wants to retain employees, he may either adopt their existing contracts or negotiate new ones on behalf of the company. An administrative receiver who adopts existing contracts is, by statute, and with no ability to contract out, personally liable in respect of services rendered wholly or partly after the adoption (IA 1986 s 44(1)(b) and (2A)–(2D)). He can, however, opt out of personal liability for newly negotiated contracts (s 44(1)(b)). Nothing the administrative receiver does in the first 14 days after appointment is taken as indicating adoption of existing contracts (s 44(2)), but if he continues to employ people and pay them according to their existing contracts after that time, he is taken to have impliedly adopted the contracts: *Powdrill v Watson* [1995] 2 AC 394.

The role of administrative receivers and their relationship to the company and its property.

[16.04] Re Atlantic Computer Systems plc [1992] Ch 505 (Court of Appeal)

The facts are immaterial.

> NICHOLLS LJ:… Typically, when lending money to a company, a bank will take as security a charge over all or most of the assets of the company, present and future, the charge being a fixed charge on land and certain other assets, and a floating charge over the remaining assets. The deed authorises the bank to appoint a receiver and manager of the company's undertaking, with power to carry on the company's business. Such a receiver is referred to in the Act of 1986 as an 'administrative receiver'.
>
> Normally the deed creating the floating charge and authorising his appointment provides that an administrative receiver shall be the agent of the company. Now the Act of 1986, in s 44(1)(a), provides that this shall always be so, unless and until the company goes into liquidation. For many years the position regarding a receiver appointed as agent of the company was that in general he was not personally liable for contracts entered into by him for and on behalf of the company. He was no more personally liable than was a director who entered into a contract for and on behalf of his company … The position now, with regard to administrative receivers, is set out in s 44(1) and (2) of the Act of 1986.[32] Under that section an administrative receiver is personally liable on (a) any contract entered into by him in the carrying out of his functions, except in so far as the contract otherwise provides, and (b) on any contract of employment 'adopted' by him in the carrying out of those functions. In the latter regard the administrative receiver has, in effect, a period of 14 days' grace after his appointment … In cases where he is personally liable an administrative receiver is entitled to an indemnity out of the assets of the company: s 44(1)(c). But even

today an administrative receiver is not, in general, personally liable, and hence the statutory indemnity out of the assets of the company does not arise, in respect of contracts adopted by him in the course of managing the company's business, other than **(p. 782)** contracts of employment. With that one special exception, personal liability is confined, in general, to new contracts made by him. Thus he is not personally liable for the rent payable under an existing lease, or for the hire charges payable under an existing hire-purchase agreement. This is not a surprising conclusion. It does not offend against basic conceptions of justice or fairness. The rent and hire charges were a liability undertaken by the company at the inception of the lease or hire-purchase agreement. The land or goods are being used by the company even when an administrative receiver is in office. It is to the company that, along with other creditors, the lessor and the owner of the goods must look for payment.

Nor is a lessor or owner of goods in such a case entitled to be paid his rent or hire instalments as an 'expense' of the administrative receivership, even though the administrative receiver has retained and used the land or goods for the purpose of the receivership. The reason is not far to seek. The appointment of an administrative receiver does not trigger a statutory prohibition on the lessor or owner of goods such as that found in s 130 in the case of a winding-up order. If the rent or hire is not paid by the administrative receiver the lessor or owner of the goods is at liberty, as much after the appointment of the administrative receiver as before, to exercise the rights and remedies available to him under his lease or hire-purchase agreement. Faced with the prospect of proceedings, an administrative receiver may choose to pay the rent or hire charges in order to retain the land or goods. But if he decides not to do so, the lessor or owner of goods has his remedies. There is no occasion, assuming that there is jurisdiction, for the court to intervene and order the administrative receiver to pay these outgoings …

➢ Note

IA 1986 s 44 has been amended since Nicholls LJ delivered his judgment in the *Atlantic Computer Systems* case, to meet the difficulties revealed in *Powdrill v Waston*and *Talbot v Cadge* [1995] 2 AC 394, HL (and more particularly in the rulings of the lower courts in these cases). The effect of this amendment (effected by the Insolvency Act 1994 s 2) is to make it clear that the receiver's personal liability is restricted to payments due to the employee in respect of services actually rendered during the receivership.

Duties of administrative receivers

This area of law remains troublesome. Clearly, the way in which an administrative receiver carries out his duties can have a profound and practical impact on the financial well-being of the security holder, the debtor company, any subsequent security holders with interests in the same assets, and any third parties who have guaranteed the secured debt. What duties, if any, does the administrative receiver owe to these parties?

[16.05] Downsview Nominees Ltd v First City Corpn Ltd [1993] AC 295 (Privy Council)

The company, which carried on a motor dealing and garage business in New Zealand, had given a first debenture to the Westpac bank and a second debenture to FCC, each secured by a floating charge over all of its assets. It had defaulted under the second debenture and FCC had appointed receivers who formed the view that the company's business was unprofitable and that it should be closed down. The company's managing director appealed to Russell (the second defendant) for help. His response was (i) to procure Downsview (a company which he controlled) to take an assignment of W bank's first debenture and (ii) to have Downsview appoint himself as a receiver under that debenture. FCC's receivers were thus ousted from any but a residual role. FCC at once offered to pay Downsview all the moneys owing under the first debenture, so that it would be redeemed and FCC's receivers could again take charge. But this offer was declined, and Russell continued to carry on the company's business, incurring **(p. 783)** further losses of over $500,000. The Privy Council held that: (i) Russell had used his powers not for the proper purpose of realising Downsview's security but in order to meet the managing director's

wish that the company should continue trading; (ii) Downsview ought to have accepted FCC's offer to redeem; and (iii) each of them should compensate FCC for its losses. But it rejected the view of the trial judge and the New Zealand Court of Appeal that any liability lay in negligence.

The opinion of the Judicial Committee was delivered by LORD TEMPLEMAN:… The first submission made on behalf of the first and second defendants is that they owed no duty to the first plaintiff because the first plaintiff was only a debenture holder and not a mortgagee. This submission is untenable.

A mortgage, whether legal or equitable, is security for repayment of a debt. The security may be constituted by a conveyance, assignment or demise or by a charge on any interest in real or personal property … A security issued by a company is called a debenture but for present purposes there is no material difference between a mortgage, a charge and a debenture. Each creates a security for the repayment of a debt.

The second argument put forward on behalf of the first and second defendants is that though a mortgagee owes certain duties to the mortgagor, he owes no duty to any subsequent encumbrancer, so the first and second defendants owed no duty to the first plaintiff. This argument also is untenable. The owner of property entering into a mortgage does not by entering into that mortgage cease to be the owner of that property any further than is necessary to give effect to the security he has created. The mortgagor can mortgage the property again and again. A second or subsequent mortgage is a complete security on the mortgagor's interests subject only to the rights of prior encumbrancers. If a first mortgagee commits a breach of his duties to the mortgagor, the damage inflicted by that breach of duty will be suffered by the second mortgagee, subsequent encumbrancers and the mortgagor, depending on the extent of the damage and the amount of each security. Thus if a first mortgagee in breach of duty sells property worth £500,000 for £300,000, he is liable at the suit of any subsequent encumbrancer or the mortgagor. Damages of £200,000 will be ordered to be taken into the accounts of the first mortgagee or paid into court or to the second mortgagee who, after satisfying, as far as he can, the amount of any debt outstanding under his mortgage, will pay over any balance remaining to the next encumbrancer or to the mortgagor if there is no subsequent encumbrancer …

The next submission on behalf of the first and second defendants is that, even if a mortgagee owes certain duties to subsequent encumbrancers, a receiver and manager appointed by a mortgagee is not under any such duty where, as in the present case, the receiver and manager is deemed to act as agent for the mortgagor. The fallacy in the argument is the failure to appreciate that, when a receiver and manager exercises the powers of sale and management conferred on him by the mortgage, he is dealing with the security; he is not merely selling or dealing with the interests of the mortgagor. He is exercising the power of selling and dealing with the mortgaged property for the purpose of securing repayment of the debt owing to his mortgagee and must exercise his powers in good faith and for the purpose of obtaining repayment of the debt owing to his mortgagee. The receiver and manager owes these duties to the mortgagor and to all subsequent encumbrancers in whose favour the mortgaged property has been charged.

The next question is the nature and extent of the duties owed by a mortgagee and a receiver and manager respectively to subsequent encumbrancers and the mortgagor.

Several centuries ago equity evolved principles for the enforcement of mortgages and the protection of borrowers. The most basic principles were, first, that a mortgage is security for the repayment of a debt and, secondly, that a security for repayment of a debt is only a mortgage. From these principles flowed two rules, first, that powers conferred on a mortgagee must be exercised in good faith for the purpose of obtaining repayment and secondly that, subject to the first rule, powers conferred on a mortgagee may be exercised although the consequences may be disadvantageous to the borrower. These principles and rules apply also to a receiver and manager appointed by the mortgagee.

(p. 784) It does not follow that a receiver and manager must immediately upon appointment seize all the cash in the coffers of the company and sell all the company's assets or so much of the assets as he chooses and considers sufficient to complete the redemption of the mortgage. He is entitled, but not bound, to allow the company's business to be continued by himself or by the existing or other executives. The

decisions of the receiver and manager whether to continue the business or close down the business and sell assets chosen by him cannot be impeached if those decisions are taken in good faith while protecting the interests of the debenture holder in recovering the moneys due under the debenture, even though the decisions of the receiver and manager may be disadvantageous for the company … But since a mortgage is only security for a debt, a receiver and manager commits a breach of his duty if he abuses his powers by exercising them otherwise than 'for the special purpose of enabling the assets comprised in the debenture holders' security to be preserved and realised'[33] for the benefit of the debenture holder. In the present case the evidence of the second defendant himself and the clear emphatic findings of Gault J show that the second defendant accepted appointment and acted as receiver and manager not for the purpose of enforcing the security under the Westpac debenture but for the purpose of preventing the enforcement by the plaintiffs of the [FCC] debenture.

This and other findings to similar effect establish that, ab initio and throughout his receivership, the second defendant did not exercise his powers for proper purposes. He was at all times in breach of the duty, which was pleaded against him, to exercise his powers in good faith for proper purposes.

Gault J rested his judgment not on breach of a duty to act in good faith for proper purposes but on negligence. He said:

> on an application of negligence principles, a receiver owes a duty to the debenture holders to take reasonable care in dealing with the assets of the company … [The first defendant's] position is merely a specific example of the duty a mortgagee has to subsequent chargeholders to exercise its powers with reasonable care …

Richardson J, delivering the judgment of the Court of Appeal, agreed that duties of care in negligence as defined by Gault J were owed by the second defendant as receiver and manager and by the first defendant as first debenture holder to the plaintiffs as second debenture holders. Richardson J agreed that the second defendant was in breach of his duty but, differing from Gault J, held that the first defendant had committed no breach.

The general duty of care said to be owed by a mortgagee to subsequent encumbrancers and the mortgagor in negligence is inconsistent with the right of the mortgagee and the duties which the courts applying equitable principles have imposed on the mortgagee. If a mortgagee enters into possession he is liable to account for rent on the basis of wilful default; he must keep mortgage premises in repair; he is liable for waste. Those duties were imposed to ensure that a mortgagee is diligent in discharging his mortgage and returning the property to the mortgagor. If a mortgagee exercises his power of sale in good faith for the purpose of protecting his security, he is not liable to the mortgagor even though he might have obtained a higher price and even though the terms might be regarded as disadvantageous to the mortgagor. *Cuckmere Brick Co Ltd v Mutual Finance Ltd*[34] is Court of Appeal authority for the proposition that, if the mortgagee decides to sell, he must take reasonable care to obtain a proper price but is no authority for any wider proposition. A receiver exercising his power of sale also owes the same specific duties as the mortgagee. But that apart, the general duty of a receiver and manager appointed by a debenture holder … leaves no room for the imposition of a general duty to use reasonable care in dealing with the assets of the company. The duties imposed by equity on a mortgagee and on a receiver and manager would be quite **(p. 785)** unnecessary if there existed a general duty in negligence to take reasonable care in the exercise of powers and to take reasonable care in dealing with the assets of the mortgagor company …

A mortgagee owes a general duty to subsequent encumbrancers and to the mortgagor to use his powers for the sole purpose of securing repayments of the moneys owing under his mortgage and a duty to act in good faith. He also owes the specific duties which equity has imposed on him in the exercise of his powers to go into possession and his powers of sale. It may well be that a mortgagee who appoints a receiver and manager, knowing that the receiver and manager intends to exercise his powers for the purpose of frustrating the activities of the second mortgagee or for some other improper purpose or who fails to revoke the appointment of a receiver and manager when the mortgagee knows that the receiver and manager is

abusing his powers, may himself be guilty of bad faith but in the present case this possibility need not be explored.

The liability of the second defendant in the present case is firmly based not on negligence but on the breach of duty. There was overwhelming evidence that the receivership of the second defendant was inspired by him for improper purposes and carried on in bad faith, ultimately verging on fraud. The liability of the first defendant does not arise under negligence but as a result of the first defendant's breach of duty in failing to transfer the Westpac debenture to the first plaintiff at the end of March 1987. It is well settled that the mortgagor and all persons having any interest in the property subject to the mortgage or liable to pay the mortgage debt can redeem. It is now conceded that the first plaintiff was entitled to require the first defendant to assign the Westpac debenture to the first plaintiff on payment of all moneys due to the first defendant under the Westpac debenture …

The first defendant was from the end of March 1987 in breach of its duty to assign the Westpac debenture to the first plaintiff. If that debenture had been assigned, the second defendant would have ceased to be the receiver and manager and none of the avoidable losses caused by the second defendant would have been sustained …

A receiver who is appointed to manage the business of the chargor has a duty to do so with due diligence.

[16.06] Medforth v Blake [2000] Ch 86 (Court of Appeal)

Medforth was a pig farmer on a very large scale: his annual turnover was over £2 million. He ran into financial difficulties and his bank appointed receivers, who ran the business for four-and-a-half years, until Medforth was able to find a new source of finance and repay the bank. Although Medforth repeatedly told the receivers that they could claim large discounts from the suppliers of feedstuffs, amounting to some £1,000 a week, they failed to do so. The court held that the receivers owed a duty (subject to their primary duty to the bank) to manage the business with due diligence, and that for breach of this duty they were liable to Medforth.

SIR RICHARD SCOTT V-C:… As a Privy Council case, the *Downsview Nominees* case **[16.05]** is not binding but, as Mr. Smith submitted, is a persuasive authority of great weight. But what did it decide as to the duties owed by a receiver/manager to a mortgagor? It decided that the duty lies in equity, not in tort. It decided that there is no general duty of care in negligence. It held that the receiver/manager owes the same specific duties when exercising the power of sale as are owed by a mortgagee when exercising the power of sale. Lord Templeman cited with approval the *Cuckmere Brick* case [1971] Ch 949 test, namely, that the mortgagee must take reasonable care to obtain a proper price …

The *Cuckmere Brick* case test can impose liability on a mortgagee notwithstanding the absence of fraud or mala fides. It follows from the *Downsview Nominees* case and *Yorkshire Bank plc v Hall* [1999] 1 WLR 1713 that a receiver/manager who sells but fails to take reasonable care to obtain a proper price may incur liability notwithstanding the absence of fraud or mala fides. Why should the approach be any different if what is under review is not the conduct of a sale but conduct in carrying **(p. 786)** on a business? If a receiver exercises this power, why does not a specific duty, corresponding to the duty to take reasonable steps to obtain a proper price, arise? If the business is being carried on by a mortgagee, the mortgagee will be liable, as a mortgagee in possession, for loss caused by his failure to do so with due diligence. Why should not the receiver/manager, who, as Lord Templeman held, owes the same specific duties as the mortgagee when selling, owe comparable specific duties when conducting the mortgaged business? It may be that the particularly onerous duties constructed by courts of equity for mortgages in possession would not be appropriate to apply to a receiver. But, no duties at all save a duty of good faith? That does not seem to me to make commercial sense nor, more importantly, to correspond with the principles expressed in the bulk of the authorities …

I do not accept that there is any difference between the answer that would be given by the common law to the question what duties are owed by a receiver managing a mortgaged property to those interested in the

equity of redemption and the answer that would be given by equity to that question. I do not, for my part, think it matters one jot whether the duty is expressed as a common law duty or as a duty in equity. The result is the same. The origin of the receiver's duty, like the mortgagee's duty, lies, however, in equity and we might as well continue to refer to it as a duty in equity.

In my judgment, in principle and on the authorities, the following propositions can be stated. (1) A receiver managing mortgaged property owes duties to the mortgagor and anyone else with an interest in the equity of redemption. (2) The duties include, but are not necessarily confined to, a duty of good faith. (3) The extent and scope of any duty additional to that of good faith will depend on the facts and circumstances of the particular case. (4) In exercising his powers of management the primary duty of the receiver is to try and bring about a situation in which interest on the secured debt can be paid and the debt itself repaid. (5) Subject to that primary duty, the receiver owes a duty to manage the property with due diligence. (6) Due diligence does not oblige the receiver to continue to carry on a business on the mortgaged premises previously carried on by the mortgagor. (7) If the receiver does carry on a business on the mortgaged premises, due diligence requires reasonable steps to be taken in order to try to do so profitably …

[His Lordship accordingly ruled that the trial judge had rightly held the receivers liable for breach of duty.]

SWINTON THOMAS and TUCKEY LJJ concurred.

➢ Questions

1. Does the duty described in *Downsview* **[16.05]** meet commercial needs and expectations? Does it contribute to a 'rescue culture'? See G Lightman, 'The Challenges Ahead: Address to the Insolvency Lawyers' Association' [1996] JBL 113 at 119–120; contrast H Rajak, 'Can a Receiver be Negligent?' in B Rider (ed), *The Corporate Dimension* (1998).

2. Does it matter whether the receiver's duty is an equitable duty or a common law duty?[35]

3. What difference does it make to say that the receiver owes a duty of good faith, rather than a duty of care, to the company and to subsequent encumbrancers or guarantors?[36]

4. What duty does the *chargee* owe in deciding *when* or *whether* to appoint a receiver? See *Shamji v Johnson Matthey Bankers Ltd* [1986] BCLC 278, Ch, affd [1991] BCLC 36, CA. If an offer is made to redeem the secured debt (thereby extinguishing the charge), must the debenture holder accept it?

(p. 787) 5. What duty does the *receiver* owe in deciding *whether* to exercise the power of sale or continue the business, and in deciding *when* to sell? See *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949, CA.

6. Is the duty owed by the receiver when exercising the power of sale or the power to carry on the business one of good faith, due diligence or reasonable care? See LS Sealy, 'Mortgagees and Receivers—A Duty of Care Resurrected and Extended' [2000] CLJ 31; S Frisby, 'Making a Silk Purse Out of a Pig's Ear—*Medforth v Blake*' (2000) 63 MLR 413.

➢ Notes

1. Also see *International Leisure Ltd v First National Trustee Co Ltd* [2012] EWHC 1971 (Ch), discussed in the context of 'reflective losses', at Note 4 following *Giles v Rhind* **[13.23]**, pp 681.

2. In *Glatt v Sinclair* [2011] EWCA Civ 1317, applying the general principles governing the receiver's duties to the principal, the Court of Appeal ruled that there was at least an arguable case that a receiver appointed by the court pursuant to the Criminal Justice Act 1988 had committed a breach of duty in failing properly to